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FESTSCHRIFT FOR RAUL V. FABELLA

Guest Co-editors — **Emmanuel S. de Dios**, **Sarah Lynne S. Daway-Ducanes**

ARTICLES IN THIS ISSUE

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PRE

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Festschrift for Raul V. Fabella

This special edition of the *Philippine Review of Economics* honors Dr. Raul V. Fabella in his 70th year and recognizes his invaluable contribution to the economics discipline and profession. This edition comprises 13 articles from his colleagues and several generations of former students inspired or mentored by Dr. Fabella who are themselves making their mark in economics. The broad spectrum of topics covered—agricultural economics, competition policy, contract theory, game theory, history of economic thought, international economics, issues in productivity, growth and development, monetary policy, political economy and rent-seeking, public economics, and the theory of teams—are issues that Dr. Fabella himself has written on or taught his students during his long, productive years as a Professor of Economics at the UP School of Economics, nurturing an "oasis of excellence" in his spheres of influence, as well as advocated as a roving academic in his later years, endeavoring to engage policymakers and the public in general, in pursuit of welfare-improving changes for a better Philippines.

The wide gamut of topics in this issue is a testament to Dr. Fabella's eclectic intellectual interests yet unwavering devotion to upholding a high standard of academic excellence. As his biographical sketch at the National Academy of Science and Technology summarizes:

> Fabella's very development as a scholar and intellectual leader presents numerous paradoxes: a classicist turned mathematical economist; a rational-choice theorist who derives material and metaphor from both history and physics; a solitary thinker who agonizes over pedagogy; a pure theorist immersed in policy-debate; an inherently shy, private man who must deal with crowds. His career displays to the fullest the range of issues – from the mathematical to the moral – that economists can and must confront if they are to attain to that "cool head and warm heart" that was Marshall's ideal. A classicist, however, might simply recall Terentius: *Homo sum: humani nil a me alienum puto*.

Indeed, to Dr. Fabella, nothing related to human behavior is outside his interest. At 70 years of age, National Scientist of the National Academy of Science and Technology (Philippines) and Professor Emeritus at the University of the Philippines, he is yet to reach the zenith of his intellectual verve: Fabella the economist is transfiguring into Fabella the social scientist – one to whom *homo economicus* is no longer the norm, but the exception in the vast complexity of human interactions in society. It is thus unlikely that this will be the last festschrift in his honor.

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Sovereign determination or disguised protectionism?: the Vitamin C Case

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When a sovereign state vouches for the anti-competitive behavior of its producers, it is incumbent upon the courts to abstain from adjudicating and allow economic diplomacy to take its course. The recent decision of the US Supreme Court on a cartel case involving Chinese exporters of vitamin C appears to favor pro-active judicial enforcement of antitrust law, however. Comity among nations calls for giving due deference to the legitimate choices of others with respect to regulating competition in their own industries. But a state harmed by the anti-competitive conduct of foreign producers faces the difficult choice between protecting its own interest and avoiding intrusion into the conduct of another sovereign state. This paper explores this conundrum, which has implications on states with a development agenda that subordinates competition to industrial goals.

JEL classification: L52, F1
Keywords: export cartel, international comity, foreign sovereign compulsion, industrial policy

1. Introduction

Since the second half of 2000, just a few years after China's accession to the World Trade Organization (WTO) and a decade before China became a threat to US economic hegemony, the world's two largest economies have been engaged in a web of antitrust and trade disputes. At issue is China's idiosyncratic governance, which could be perceived as backtracking on multilateral commitments, and US tenacity to defend its national interests and preserve the rules-based global order. The provenance of this odyssey is a cartel case against Chinese exporters of vitamin C.

In 2005, a class suit was filed before the US District Court, Eastern District New York (hereafter, "district court") against four Chinese manufacturers of vitamin C for conspiracy to fix price and restrict output in violation of US competition

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law.[1] The Chinese sellers did not deny the allegation, but claimed that their own government compelled them to coordinate prices and the supply of exports under threat of sanction. Accordingly, they moved to dismiss the complaint on sovereign grounds. The China Ministry of Commerce (MOFCOM) filed an *amicus curiae* brief to vouch for the defendants' cartel behavior. MOFCOM explained that it had been regulating exports, including price control, to fend off antidumping suits in the WTO. Despite this pronouncement, the district court denied the motion and awarded treble damages to the plaintiffs in 2012.

Four years later, the Second Circuit (hereafter "appeals court") reversed the order of the district court and held that the case should have been dismissed on international comity grounds.[2] Courts are "bound to defer" to a foreign government's construction of its laws whenever such construction is reasonable, the appeals court argued. Further, since the defendants were acting on the direction of their government, they could not have simultaneously complied with the US antitrust law that conflicts with their national law. To penalize the defendants who are caught between the rock of domestic law and the hard place of US law is unreasonable and unfair.

But in June 2018, the US Supreme Court (hereafter "Supreme Court") issued a unanimous opinion that courts are not bound to give "conclusive effect" to a foreign government's testimony, contrary to the position taken by the appeals court. A "respectful consideration" instead suffices; a foreign government's submission on the meaning and interpretation of its own law must be weighed against other evidence on hand. The decision vacated the ruling of the appeals court but did not resolve the case in favor of any party. It remains to be seen how it will influence the lower courts' appreciation of evidence, especially those provided by the Chinese government.

Legal scholars are divided over the decision of the Supreme Court and its influence on the resolution of the *Vitamin C* case and similar future disputes. One group holds the view that the standard of respectful consideration lacks clarity to guide courts in extraterritorial application of competition laws.[3] This poses risks of inconsistent application and of producing judicial decisions that encroach on the sovereign authority of another nation. A court determination that offends the interests of a foreign state could have profound implications on the relationship between sovereign states. Another group views the decision necessary since the alternative amounts to a court's abdication of its jurisdiction and undermines

[1] *Animal Science Products, Inc., et al. v. Hebei Welcome Pharmaceutical Co. Ltd., et. al.*, [hereafter, the *Vitamin C* case].

[2] With reference to the 1993 case of *Hartford v. California*, international comity is a legal doctrine that prescribes court abstention in exercising jurisdiction out of respect for foreign sovereignty, in case of conflict between domestic and foreign law, judgment from foreign court or parallel foreign legal proceeding in a foreign forum [Wang 2012: 1107].

[3] See, for example, Streicher and Lee [2018] and Parenthood [2019].

the territorial reach of antitrust law.[4] A binding deference exposes the court to misrepresentation and undue influence from a foreign government. Moreover, the application of international comity is a voluntary act that should be taken only after weighing the impact of foreign conduct on national interest against the potential repercussion of asserting jurisdiction.

Apart from the issue of deference to a foreign government's interpretation of its own laws, the *Vitamin C* case presents an equally perplexing issue on whether competition law should be allowed to interface with industrial and trade policies. Competition laws are domestic in scope and substance (or regional in the case of the European Union). They are not governed by international agreements, unlike trade laws. Some competition laws are technocratic, i.e., concerned almost exclusively with improving economic efficiency, while others strive to balance development goals and market competition. In China and other developing economies, competition laws are infused with industrial policy objectives, hence they may be applied to protect home markets from foreign competition, promote national champions, or force transfers of technology from foreign to domestic producers. By contrast, most developed countries insulate their antitrust enforcement from other policy concerns.

Although competition laws are inherently domestic in application, the lack of coherence among national competition laws[5] has been a source of conflict between sovereign states when the effects of anti-competitive conduct committed in one state cross the border of another, or a sovereign state is involved or implicated. In the cartel suit against Chinese exporters of vitamin C, both conditions apply. The conduct of private parties, committed outside US territory, was upon the direction of a foreign sovereign state and had adverse impact on US consumers.

Jurisdictional conflicts are bound to arise for as long as the responsibility of the state for the anti-competitive conduct of its producers is not addressed. At present, no multilateral agreement on competition enforcement exists, not even within the WTO. While comity is a long-standing legal doctrine, it is not part of international law, and therefore its application is discretionary on the part of the state.

The root of the conflict is the dichotomy in antitrust enforcement. The object of enforcement is to redress anti-competitive conduct affecting domestic commerce, regardless of where committed and the nationality of violator. Conduct that harms foreign commerce exclusively is however considered outside the remit of antitrust enforcement. Therefore, competition enforcement is resolute in any form of price fixing in the domestic market. But when domestic producers fix prices in a foreign market, competition enforcement blinks.

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[4] See, for example, Clarke and Hewson [2018] and Brunel and Stutz [2018].

[5] Besides differences in motivations, standards, procedures and approaches of antitrust enforcement diverge across states as they mirror the quality of domestic institutions, legal tradition and socio-political structures, among others.

Clipping the reach of antitrust enforcement in this manner is consistent with the generally recognized reason for competition law, namely to regulate domestic market competition. It is not the intention of the law to regulate the condition of competition in a foreign market; otherwise, the laws of one state could be used to encroach on the sovereignty of another state. But this perspective could also serve as pretext for a mercantilist agenda to keep export cartels[6] unfettered. Tacit or open sponsorship of export cartel is explained away by exigencies of economic development, specifically to nurture home industries that could survive competition in international markets.

Still, sanctioning anti-competitive conduct to advance one's development, even if it harms another state, is a beggar-thy-neighbor policy. It raises several confounding issues. Does a sovereign right to nurture domestic industries justify forbearance for anti-competitive behavior that harms foreign commerce? Do export cartels from developing countries deserve wider latitude than their counterparts from developed countries? Where should a state on the receiving end of anti-competitive conduct by foreign producers draw the line between protecting the interest of its consumers and avoiding undesirable intrusion into the conduct of another sovereign state?

This article explores these issues through the lens of the *Vitamin C* case. More than a question of competition infringement, the case impinges on the sovereign right of the state to define its own development strategy and has profound implications on global trade and antitrust governance.

Section 2 critically examines the facts of the *Vitamin C* case, China's motivation and defences, and divergent views of US courts on the level of deference to afford a foreign government's interpretation of its nation's law. The conduct of Chinese producers is not the only issue on trial, but also China's trade and industrial policies.

The crux of the *Vitamin C* case is the real conflict in the policy regimes of US and China. Section 3 examines the evolution of China's competition law and underscores the interface between competition, trade and industrial policies. Other developing economies have similar policy interfaces, which, however, receive a different treatment from the US government and courts. A striking contrast to the current impasse is the experience of Japan in the 1970s when it was in a similar bind as China because of the influx of cheap Japanese goods in the US market. Although the resolutions in the US-China and US-Japan cases are different, it stands to reason that other developing countries, emulating the Japanese or Chinese development path, could be caught in a similar entanglement.

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[6] The OECD [1974] provides a useful classification of export cartels according to composition and market impact. A national (pure) export cartel refers to producers from the same jurisdiction whose anti-competitive conduct is directed exclusively at foreign markets. A mixed export cartel is national in composition but affects both domestic and foreign commerce. An international export cartel is composed of exporters from different jurisdictions. Sovereign defences could be applied only to national and mixed export cartels.

The final section concludes that the recent Supreme Court decision on the *Vitamin C* case may signal a more limited use of comity in the future. This could result in more transnational commercial disputes being challenged as antitrust cases in courtrooms. Since courts are less attuned to regulatory differences compared to multilateral forums, there is less scope for industrial policies to trump competition laws, and greater prospect for the laws of one state to supplant the laws of another.

2. The perplexing case of vitamin C

2.1. Antecedent

Between 1985 and early 1999, twenty-one chemical manufacturers, headquartered in seven countries, were found to have conspired in manipulating the international prices and supply of vitamins, sold in bulk or blends. The "big four", viz., European manufacturers F. Hoffmann LaRoche, Ltd., Merck KgaA, and BASF AG and Japanese company Takeda Chemical Industries Ltd., controlled nearly 80 percent of global sales at that time. Because of the spadework by the US Department of Justice (DOJ), more than 100 lawsuits were initiated against the vitamins cartels in at least nine countries and the European Union. Record fines were imposed on the companies, and several foreign executives were imprisoned in the US. More importantly, the cases prompted the US Supreme Court to clarify the conditions for which the 1890 Sherman Act applies to international cartels [Inklaar and Rao 2014].

Case law referred to the "Vitamins Cartel" as a web of 16 cartels that were defined along vitamin classes, but linked by cross-memberships. Each vitamin class is a market in itself, with distinguishable demand and supply. The metabolic functions of vitamins are different across classes; hence vitamin A is not a substitute for vitamin B1, for example [ibid.].[7] The manufacturing processes are also unique to each vitamin; therefore, facilities and knowhow in the production of one vitamin could not be shifted to another. Absent demand and supply substitutability, these cartels could exist independently of each other, despite having common members. However, few vitamin manufacturers are diversified; many are specialized. F. Hoffmann LaRoche was unique insofar as it was a member of 13 out of 16 cartels [ibid.].

Other factors contributed to the cartelization of vitamins. First, the product varieties within a vitamin class are homogeneous as to molecular structure and biological properties; thus, price is the main driving factor for demand. An agreement among competitors to fix price avoids cutthroat competition that could harm everyone. Second, entry barriers are high because of proprietary technology

[7] Within a vitamin class, products are further differentiated as to whether the commodity is for human consumption or animal feed.

and large capital requirement for mass production. The competitive threat from outside the industry and non-cartel members (usually small and specialized producers) is oftentimes weak. Third, it has been customary to maintain the same premium on the price of vitamin for human consumption over the price of the same vitamin for animal feed. This is convenient for the cartel since the members have to agree on only one price. Finally, during the period of cartelization, there was surplus capacity that could have caused oversupply and depressed prices if it were not for a collusive agreement.

The barriers to entry are different in each of the 16 vitamins, but mostly insurmountable for developing countries with weak innovation systems. For instance, the markets for oil-soluble vitamins (A, B3, D and E) are more difficult to penetrate, thus they remain dominated by European manufacturers. China is an exception because it has been producing vitamin C since the late 1950s at a much lower cost than European manufacturers. Its commercial production was however boosted only in the 1980s when the government began investing heavily in R&D and targeting support to products with high export potential. As Chinese producers deepened their knowledge of synthetic chemistry, they eventually gained access to the US market in six vitamins: C, B1, B2, B6, B12, and folic acid, and overcame the quality stigma that is often attached to low prices. By 1996, China's vitamin C exports accounted for 54 percent of US imports and were already sold at premium prices [Connor 2004].

Unlike their Japanese counterparts, Chinese vitamins producers were not conscripted to the European-led cartel. This may be due to their being small, numerous and aggressive in pricing, which make them predisposed to defect. But government subsidies allowed them to maintain low prices, which eventually undermined the European cartels. Significantly, the cartels that were challenged by Chinese producers collapsed ahead of other cartels and even before the courts ordered them to disband.[8] Shortly after, the Chinese manufacturers transmogrified from aggressive fringe firms to architects of their own cartel.

2.2. In defence of economic development

Court records reveal that the Chinese vitamins producers attempted but failed to form a cartel as early as 1995. Upon government instigation, the Chinese industry consolidated into four major manufacturers, all of whom were named defendants in the *Vitamin C* case. At a meeting facilitated by the China Chamber of Commerce of Medicines (hereafter, "Chamber") in December 2001, the defendants agreed to cut the volume of their exports to put a halt on the declining price trend. Following this meeting, the price of vitamin C in the US market

[8] See Igami and Sugaya [2017] for empirical evidence of vitamin C cartel behavior during 1990-1997. Of interest is how the cartel's miscalculation on the output behavior of Chinese producers led to its fall.

rose nearly threefold (from $2.50 to $7 per kilogram). On several occasions between 2002 and 2004, the defendants met to coordinate prices, production and distribution to the US and other markets, to create supply shortage in the global market in order to stabilize prices, and to deal with price cutting members.[9]

The defendants did not refute the allegations of the complainants but argued that they have immunity from antitrust liability because their government forced them to engage in the very acts that violated the US law. They asked the court to dismiss the complaint based on legal doctrines of act of state, foreign sovereign compulsion, and international comity. These defences are interrelated and stand on respect for the sovereignty of other nations. They provide a basis for a court to abstain from exercising jurisdiction and allow the matter to be resolved through diplomacy. By abstaining, courts avoid condemning the conduct of a foreign government, which could affect the amicable relationship between two sovereign states. Because of separation of powers between the executive and judicial branches of government, matters of foreign relation are left to the executive branch. It is also prudent for courts to abstain so they could avoid being dragged into the political agenda of the executive.[10]

Various case laws define the conditions that could give rise to the application of sovereignty-based defences. The act of state defence is recognized when a foreign government commits an anti-competitive conduct within its territorial jurisdiction, and the conduct is related to its governmental, not commercial, function.[11] On the other hand, private parties may put up a foreign sovereign compulsion defence if they were compelled by their government to commit anti-competitive conduct under threat of severe sanction. Courts admit compulsion defence out of fairness to the defendant caught between conflicting legal obligations of two sovereign states.[12] Finally, international comity is the principle of recognizing within the territory of one nation the legislative, executive or judicial acts of a foreign sovereign. Such recognition leads to court abstention over those acts, after weighing the value of foreign relation against the interest of domestic consumers. Comity is considered in cases of "true conflict between domestic and foreign law", which happens when the defendant is required by foreign law to act in a manner prohibited by domestic law, or when it is impossible for the defendant to comply with the laws of both countries.[13]

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[9] The complainants, Animal Sciences Products, Inc. and Ranis Company, Inc., use vitamin C as production inputs. They are claiming damages under Section 1 of the Sherman Act and Sections 4 and 16 of the Clayton Act for loss of business income and jobs of their employees.

[10] A similar view was articulated by Kadish [1982] in the *Timberlane* case.

[11] Section 3.31 of "Antitrust Enforcement Guidelines for International Operations" issued by U.S. Department of Justice and Federal Trade Commission, 1995.

[12] Ibid. Section 3.32.

[13] Ibid. Section 3.2.

To bolster the defendants' position, MOFCOM[14] submitted an *amicus curiae* brief and appeared before the US courts for the first time. The *amicus* brief confirms three key points: the continuous use of export controls, which runs counter to China's accession commitment; the role of the Chamber as a parastatal organization in implementing such controls; and the alignment of price collusive behavior of Chinese exporters with their government trade policy.

MOFCOM explained that it directed the Chamber in 1997 to create a subcommittee that administered the grant of export license to vitamin C manufacturers. Licenses were awarded only to members complying with the industry-negotiated price and quota. However, in 2002, the government had to discontinue the use of export quotas to comply with WTO rules. The Chamber replaced it with a price verification and chop (PVC) scheme. Under the scheme, members agree on a minimum export price. A manufacturer is required to submit an export customs document to the Chamber indicating the price and amount it plans to export. The Chamber "verifies" the contract price and affixes a "chop" (seal) to the customs document if the price is at or above the minimum agreed price.

The new policy was ostensibly prompted by China's accession to WTO since the GATT expressly prohibits the imposition of export quotas and licenses. But the government was concerned that it would continue to court anti-dumping cases if its producers were not restrained from engaging in price competition. A WTO-inconsistent measure was thus replaced with another that appears to be privately initiated, yet still achieves the same objective.

Taken at face value, the sum of the Chinese government testimony could have immediately led to the conclusion that the collusive behavior of vitamin C manufacturers was government-compelled, hence courts should abstain based on comity. As it happened, US courts had conflicting views on the amount of deference to accord to a foreign government's testimony, which in turn stemmed from different interpretations of the meaning and purpose of comity. This resulted in different rulings of the district court and appeals court on whether to hold the defendants liable for antitrust violation or to refrain from censuring a foreign sovereign state in a domestic court system. It turns out that the schism is deeper than is revealed in the *Vitamin C* case.

2.3. Deference

At the core of the disagreement between courts is the interpretation of Rule 44.1 of the US Federal Rules of Civil Procedure, which stipulates that "any relevant material or source, including testimony, whether or not submitted by any party" may be considered in determining foreign law, and that such determination is a "question of law", not "of fact".

[14] MOFCOM is recognized as the highest body in China with authority to represent the state in matters involving foreign trade.

It is widely acknowledged that Chinese law has its own standard of transparency different from US law; that regulations promulgated by ministries, instead of statutes, embody Chinese government policies; and that private individuals may be given authority to exercise regulatory functions by Chinese ministries. The Ministry's brief on the role of the Chamber buttressed this understanding:[15]

> As a social body formed along business lines and enjoying the status of legal person, the Chamber is composed of economic entities registered in the People's Republic of China dealing in medicinal items as authorized by the departments under the State Council responsible for foreign economic relations and trade as well as organizations empowered by them…*The Chamber abides by the state laws and administrative statutes, implements its policies and regulations governing foreign trade*, accepts the guidance and supervision of the responsible Departments under the States' Council. *The very purpose is to coordinate and supervise the import and export operations in this business*, to maintain business order and protect fair competition, to safeguard the legitimate rights and interests of the state, the trade and the members and *to promote the sound development of foreign trade in medicinal items.* (Italics supplied.)

Notwithstanding, the district court placed more weight on evidence contradicting the defendants' claim than on the statement of the Chinese government. One such evidence is a public announcement by the Chamber that its members reached a "self-regulated agreement" to "voluntarily control the quantity and pace of exports" and to implement such agreement "without any government intervention". This suggests that the export prices in question could have been a result of private negotiation, not an act of state as the defendants claim. The district court likewise noted that no actual sanction was meted against producers who deviated from the minimum agreed price—additional proof that the Chinese producers had discretion to set their own price. In short, the district court was persuaded by the complainants' position that Chinese law did not require the defendants to engage in price fixing, in fact or in law; thus, their conduct was voluntary and US antitrust law applies.[16]

For the district court, the provision of Rule 44.1 allowing "any relevant material or source" gives it "substantial discretion to consider different types of evidence" apart from the Ministry's testimony. The balance of evidence, in its view, is "too ambiguous" to rule out the possibility that the defendants were acting voluntarily, rather than at the express order or mandate of the government. Granting the cartel exists with government permission, the court found difficulty distinguishing between "a cartel that was voluntarily formed by its members, who then had to seek governmental approval, and a cartel that was mandated by governmental fiat".[17] Because of this, the district court hesitated to accept the sovereign compulsion defence.

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[15] Amicus Brief 1-2, *In re Vitamin C Antitrust Litigation No. 13-4791*, ECF No. 293

[16] *In re Vitamin C Antitrust Litigation*, 584 F. Supp. 2d 546 [E.D.N.Y 2008].

[17] Ibid.

In reversing the ruling of the district court, the appeals court underscored the differences in the American and Chinese legal and economic systems. The true intent and design of a policy could be lost in plain reading of law, without nuanced understanding of the system under which it was written. In the Chinese system, for instance, it is erroneous to interpret terms such as "industry self-regulation" and "voluntary restraint" as pure private acts when government expects and ensures that private individuals behave in the same way under a set-up with visible government enforcement. Thus, the appeals court argued that the district court should have deferred to the Ministry's explanation of its own law and system.[18]

Additionally, the appeals court objected to the rejection of sovereign compulsion defence on the ground that the defendants may not have been constrained to form a cartel and only petitioned the government to approve the same *post hoc*. In its opinion, the compulsion defence is not undermined even if the cartel was not forced on the defendants. "It is enough that the Chinese law actually mandated such action, regardless of whether the [d]efendants benefited from, complied with, or orchestrated the mandate." The uneven enforcement of the price agreement does not extinguish the mandate of the Ministry to coordinate, nor negate the Ministry's representation that the Chamber was acting in its behalf. A conflict between the laws of US and China exists, which is the basis for invoking international comity. That some producers escaped penalties from occasional non-compliance with the Chamber's coordinated price does not mean that frequent refusal to comply would not give rise to severe sanctions.

The rationale for the appeals court reversal was explained as follows:[19]

> We balance the interests in adjudicating antitrust violations alleged to have harmed those within our jurisdiction with the official acts and interests of a foreign sovereign in respect to economic regulation within its borders. When, as in this instance, we receive from a foreign government an official statement explicating its own laws and regulations, we are bound to extend that explication the deference long accorded such proffers received from foreign governments. Here, because the Chinese Government filed a formal statement in the district court asserting that Chinese law required Defendants to set prices and reduce quantities of vitamin C sold abroad, and because Defendants could not simultaneously comply with Chinese law and U.S. antitrust laws, the principles of international comity required the district court to abstain from exercising jurisdiction in this case.

[18] To this point, the appeals court cited its own decision in another case that also required determination of foreign law (*Karaha Bodas v. Ministry of Finance of the Republic of Indonesia*): "Where a choice between two interpretations of ambiguous foreign law rests finely balanced, the support of a foreign sovereign for one interpretation furnishes legitimate assistance in the resolution of interpretative dilemmas."

[19] *In re Vitamin C Antitrust Litigation*, 837 F.3d 175 [2d Cir. 2016].

Underscoring the deference due to the Ministry's testimony, the appeals court stated further:[20]

> We reaffirm the principle that when a foreign government acting through counsel or otherwise, directly participates in U.S. court proceedings by providing a sworn evidentiary proffer regarding the construction and effect of its laws and regulations, which is reasonable under the circumstances presented, a U.S. court is bound to defer to those statements. *If deference by any measure is to mean anything, it must mean that a U.S. court not embark on a challenge to a foreign government's official representation to the court regarding its laws or regulations, even if that representation is inconsistent with how those laws might be interpreted under the principles of our legal system.* [Ibid.] (Italics supplied.)

The Supreme Court disagreed. In remanding the case to the lower court, the Supreme Court clarified that a foreign state's characterization of its own laws deserves "respectful consideration", against the conclusive effect accorded by the appeals court. It counselled the lower court not to ignore other available evidence, in keeping with Rule 44.1, and to make its own determination on what the Chinese law actually required from the defendants. The weight to be given to a foreign government's statement will depend on circumstances that may include: "the statement's clarity, thoroughness, and support; its context and purpose; the transparency of the foreign legal system; the role and authority of the entity or official offering the statement; and the statement's consistency with the foreign government's past positions". Any determination of foreign law is "de novo"; thus, "no single formula or rule will fit all cases".[21]

Some legal practitioners are apprehensive that the absence of a bright-line rule could increase the risk of erroneous and inconsistent judgment. Arguably, no one is better placed to interpret the meaning and intent of a law than the government that promulgated and enforces it. To subject an official testimony to the same scrutiny as other evidence is to accommodate the odds that a foreign government is equivocating or perjuring. Perhaps because of this awkward implication, the Supreme Court does not prevent a court from being bound when there is no contrary evidence or if the highest court, with authority to interpret the laws of the land, proffers the testimony. The Supreme Court noted, however, that the Chinese government attested before the WTO in 2002 that it had given up on export controls since its accession.[22]

[20] Ibid.

[21] *In re Vitamin C Antitrust Litigation*, 585 U.S. ____ [2018].

[22] Council for Trade in Goods, *Transitional Review Under Article 18 of the Protocol of Accession of the People's Republic of China*, WTO Doc. G/C/W/438 [Nov. 20, 2002:3].

By contrast, scholars siding with the Supreme Court decision maintain that courts should prove “true conflict” between laws before accepting compulsion defence. The lack of transparency and clarity of a foreign law should not favor deference; it should at least raise alarm that the testimony may be biased or false. A state would be ceding its antitrust jurisdiction if it uncritically accepts a foreign government’s claim. Wholesale deference might embolden foreign producers to engage in anti-competitive conduct with foreknowledge that they could rely on their home government’s defence of their behavior. If this happens, then the state capacity to enforce competition within its border would be severely weakened.

Because of differences in legal opinion on the appropriate standard of deference, the final resolution of the *Vitamin C* case is still uncertain. The lower courts may yet find evidence in support of the Chinese government’s testament and abstain from the case by reason of international comity. Alternatively, the courts may completely reject the Chinese government’s interpretation of its law and apply the antitrust penalties. But the latter possibility creates difficulty. As MOFCOM suggested in its brief, a court rejection of a foreign government statement implies either “that a U.S. court knows a country’s laws better than its own government, or that a foreign government is not being candid”. Either one is “profoundly disrespectful” of sovereignty of a foreign state.[23]

3. When competition law meets industrial policy

The legal conundrum of the *Vitamin C* case arose from the real conflict between US antitrust law and China’s competition enforcement that is inextricably linked to industrial policy. Not every type of competition and industrial policy nexus is a potential source of conflict, however. One kind of industrial policy rationalizes anti-competitive conduct or restrains pro-competitive behavior as a strategy to build national productive capacity. Yet, another kind regards competition as an instrument to promote productivity growth. The former repudiates the rules-based market order and provokes legal discord similar to the *Vitamin C* case, while the latter does not.

China’s competition law reflects a raft of economic and political challenges that accompanied its transition from a centrally planned to a market economy. This section traces key changes in market rules and enforcement structure during this transition period, underscoring elements that are relevant to the *Vitamin C* dispute. The black-letter rules may not manifest the link between competition and industrial policies, but the open-textured standards of competition rules unquestionably support such a link.

[23] Amicus Brief 1-2, *In re Vitamin C Antitrust Litigation No. 13-4791*, ECF No. 293

3.1. Regime change

With its history of strong state intervention in the economy and lack of experience in regulating private enterprises, China took a gradual and cautious approach in embracing market principles. Such prudence was understandably necessary to avoid market or social upheaval while systems and institutions were being overhauled with the change in economic regime. Before the transition began in 1978, all enterprises were government-owned and -run. Every major industry was under the control of a ministry. Producers were nearly oblivious to the notion of competition, except in the context of a race to achieve production quotas and other goals set by central planners.

To spur the growth of private enterprises, the government withdrew direct intervention in many industries that it considered “non-essential”. These are sectors, mostly in manufacturing, that do not impinge on public goods or national security and have no natural monopoly conditions to justify regulation. However, the government retained control of industries that it perceived essential to national security and economic development, such as public utilities, petroleum, banking and transportation.

Crucially, government units previously controlling production in “non-essential” industries were dissolved and replaced by trade associations and chambers of commerce that remain under the supervision of government ministries. The principal role of associations and chambers is to enforce “industrial self-discipline”, i.e., to stave off the proclivity of small and nimble enterprises to engage in fierce competition. Concretely, they facilitate price and other agreements among producers to limit competition in order to maintain some degree of market stability. Thus, while the government relinquished arms-length control, it continues to intervene in market processes through these institutions.[24]

Following the privatization of state-owned enterprises (SOEs) and the entry of foreign investments,[25] a major issue that immediately emerged was the “excessive” or “malignant” competition among private enterprises, which grew very rapidly in number but not in size.[26] By 1994, private enterprises—mostly small- and medium-scale—outnumbered SOEs by 80 to 1, and accounted for one-tenth of gross industrial output. Within just five years, the ratio grew to 100 to 1, and their share in industrial production increased to nearly one-fifth.[27]

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[24] Zimmerman [2010], citing numerous sources, clarifies that the trade associations and chambers are practically government instrumentalities and the practice of price coordination is actually a reflection of cultural scepticism on the virtues of competition.

[25] The transition to a market economy began in the late 1970s. Economic reforms accelerated in 1992, however, following official declaration of the country’s goal to establish a socialist market economy and overhaul of SOEs, taxation, banking, and foreign currency systems [Owen and Wheng 2008].

[26] Howell et al. [2019].

[27] http://www.stats.gov.cn/english/statisticaldata/yearlydata/YB1999e/m01e.htm

The perception of "excessive" competition in industries dominated by private enterprises was based on copious reports of price undercutting, substandard quality of goods, "zero" or "negative" prices and rampant false advertising campaign.[28] A record number of WTO members initiated anti-dumping cases against China, on account of alleged cutthroat competition from Chinese exporters. China was respondent to close to one-fourth of all anti-dumping cases since the establishment of WTO in 1995.[29] Apart from the *Vitamin C* case, two other price-fixing cases were filed in the US against Chinese exporters of magnesium and bauxite. In 2009, the US, European Union, and Mexico filed separate complaints against export restraints imposed by China on metal products. The disputed measures included minimum export price requirement and export quota, which violated GATT Article XI:1 and China Accession Protocol.[30]

To put order in the market amid legal challenges, China adopted a number of competition-related market regulations. The 1993 Anti-Unfair Competition Law proscribes a closed-list of trade practices, such as infringement of trademarks, bribery to buy or sell goods, false or misleading representation on quality of goods and spreading of falsehoods about a competitor. The 1998 Price Law provides for three pricing regimes: market-determined, government-guided[31] and government set, and prohibits producers from engaging in predatory pricing, price collusion, discriminatory pricing and excessive pricing.[32] In 2005, industries previously reserved to SOEs, such as electricity, telecommunications, railroad, civil aviation, petroleum and national defence, were opened to private entrepreneurs.[33] And in 2007, China passed its first comprehensive competition law, the Anti-Monopoly Law (AML), which took 13 years of drafting and extensive public consultation.[34]

[28] Intense price competition was observed in "software, foods, travel agencies, household appliances, telecommunications, maritime shipping, pharmaceuticals, insurance, banking, waste recycling, machinery, mortgage, motor vehicles, periodicals, supermarkets, Internet services, steel, textile and apparels, and even lotteries" [Owen et al. 2008:247].

[29] Specifically, a total of 1,383 cases were initiated against China. India filed the most number of cases, 228; followed by the US, 170. See https://www.wto.org/english/tratop_e/adp_e/adp_e.htm.

[30] See *China – measures related to the exportation of various raw materials*, DS 394/395/398, available at https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds394_e.htm.

[31] Article 3 of the Price Law clarifies that "government-guided prices" refer to baseline levels and range within which prices may be allowed to vary. Export prices of vitamin C agreed upon by members of the trade association is considered "government-guided" since the association works under the direction of a government ministry.

[32] These prohibitions do not apply to export prices as the Price Law applies only to acts "taking place within the territory of the People's Republic of China".

[33] This refers to the 2005 State Council's "Opinions on encouraging, supporting, and guiding the development of private capital and other non-state-owned capital" [Owen et al. 2008].

[34] Rather than advancing a new thinking, the AML consolidated and clarified various existing laws that regulated market conduct and authorized multiple agencies to enforce competition [Owen et al. 2008].

3.2. Nexus of competition law and industrial policy

The protracted drafting process was caused by long internal deliberation on the economic philosophy and policy priorities that should be reflected in the competition law. The outcome is a mixture of rules borrowed from other jurisdictions[35] and measures to address China-specific concerns such as excessive competition in some industries and dominance of SOEs and administrative monopolies in others. The process was also dragged by debates on whether it is time to espouse an efficiency-oriented competition policy that could limit the country's flexibility in implementing policies to support industrialization and long-term growth.[36] Thus, there were political pressures to use competition law to reserve the domestic market for national champions[37]; to foil foreign multinationals from dominating the Chinese market[38]; and to break technological barriers[39]. But there was also recognition of the vitality of integrating into the global economy and incompatibility of naked protectionist policies with WTO commitments. In the end, China opted for a set of market regulations that is neutral and aligned with international rules in some aspects, but open-ended in others.[40]

Evidently, the Chinese government did not cease in actively intervening in the market, despite the change in economic regime. Not all of its interventions contravened competition rules, however. An empirical assessment of China's industrial policies between 1998 and 2007 concluded that preferential policies (tax holidays, loans, subsidies and tariff protection) directed at more competitive sectors or intended to promote entry or nurture younger enterprises were more effective in raising productivity [Aghion et al. 2015]. Put differently, China successfully combined competition-friendly and competition-incompatible industrial policies, but had more significant positive outcomes from the former.

Several features of the AML provide flexibility in decision-making to balance development goals and economic efficiency whenever the two clash. The stated policy objectives, structure of governance and exemptions from enforcement are salient.

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[35] Several US organizations (e.g., Department of Justice and Federal Trade Commission) and international agencies (such as World Bank, UNCTAD and OECD) were allowed to comment on various drafts of AML.

[36] The viewpoint that adopting consumer-oriented competition rules is appropriate only after a country achieves its developmental goals persuaded developing countries to oppose initiatives within the WTO to establish a multilateral agreement on competition rules during the early 2000s. Singh [2003] and Rodriguez and Menon [2016] articulate this perspective.

[37] Industrial consolidation was promoted in strategic sectors, including pharmaceuticals, so that domestic producers could reach the scale that would allow them to compete in foreign markets.

[38] Some foreign mergers with Chinese national brands were delayed or prevented.

[39] By regulating royalties and imposing compulsory licensing requirement, for example.

[40] Horton [2016] describes the focus of China's competition enforcement, namely: securing "fair market competition" for domestic producers against foreign competitors; protecting indigenous businesses and small- and medium-sized entrepreneurs; and safeguarding long-term security and economic interests of the country through trade. Howell et al. [2009] observe China's competition philosophy was similar to the US in the 1970s before the Chicago School paradigm dominated antitrust enforcement.

3.2.1. Mixing competition and non-competition goals

Unlike other antitrust laws with a rigid or singular guidepost—whether to advance consumer welfare, promote market efficiency or prevent market concentration—AML has multiple objectives, without preordained priorities. Thus, Article 1 of the AML states:

> This Law is enacted for the purpose of preventing and restraining monopolistic conduct, protecting fair market competition, enhancing economic efficiency, safeguarding the interests of consumers and the interests of the society as a whole, and promoting the healthy development of the socialist market economy.

AML stipulates further that competition rules are envisaged to "improve macroeconomic regulation and control" and to "establish a unified, open, competitive and well-ordered market system".[41] The obscure language and mix of competition and non-competition goals may be a hedge to consider other policy goals besides preserving market competition in any given case.[42] Because of its sensitivity to multiple goals, competition enforcement could be highly politicized and unpredictable.

3.2.2. Enforcement structure

Apart from integrating non-competition goals in the law, assigning the enforcement responsibility to institutions with non-competition mandate virtually guarantees that the competition goal can take a backseat when the political leadership decides. Thus, AML enforcement was parcelled to three government ministries that have other primary mandates. MOFCOM, the foreign investment watchdog, took charge of merger review; the National Development and Reform Commission (NDRC), historically a powerful central planning body, enforced all price-related provisions of AML; and the State Administration of Industry and Commerce (SAIC), implementer of the older Anti-Unfair Competition Law, monitored all non-price related violations, such as market sharing agreements and industry association rules.[43] In other jurisdictions, a new, dedicated and independent competition authority is usually established with the institution of a comprehensive competition law.[44]

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[41] Article 4 of the AML.

[42] Svetiev and Wang [2016] illustrate how these goals informed the decisions on three competition cases: acquisition of a SOE by a foreign entity (Carlyle/Xugong), proposed merger between a multinational corporation and a Chinese national brand (Coca-cola/Huiyuan), and price-fixing agreement between foreign producers of liquid crystal display (LCD) screen.

[43] In 2018, the State Administration for Market Regulation was established to serve as a single agency responsible for all antitrust regulation and enforcement.

[44] To be precise, the AML created a new body called Anti-Monopoly Commission (AMC), which reports directly to the State Council (the highest decision-making body in China). The AMC is composed of heads of several ministries and departments. It sets general policy guidelines and coordinates the activities of the three enforcement agencies, without any decision-making or review power.

By departing from the typical unified structure of enforcement, China avoided the delay in implementing the law since the agencies have pre-AML systems for monitoring and disciplining markets. But this set-up was also designed to facilitate inter-agency consultation in adjudicating competition cases, where each agency could weigh in based on the perceived implication of the decision to their respective policy mandates. Decisions were often a result of extensive bargaining among agencies and shaped largely by non-competition policy considerations.[45]

3.2.3. Exemptions

Although the major provisions conform to the antitrust laws of other countries (specifically prohibition on anti-competitive agreements, abuse of market dominance and merger review), the AML has many unconventional provisions—specific rules for SOEs and administrative monopolies, for example—where industrial policy and competition law intersect.

Relevant to the *Vitamin C* case, the AML provides that horizontal agreement to fix price or restrict supply may be allowed when the purpose for the agreement is among those enumerated in the law; competition is not substantially restricted; and the benefits derived are shared with consumers. These conditions for exempting an activity from enforcement were adopted from the EU competition law.[46] They are deemed to warrant some amount of leniency because the restrictions on competition are considered mere "ancillary" to the main purpose of a legitimate contract, and also necessary for the realization of its potential benefits. [47] In US antitrust enforcement, the presence of ancillary restraints justifies the application of rule of reason to *per se* illegal conduct.

The AML's list of conditions justifying exemption is however expanded and open-ended compared to EU law. Apart from improving production or distribution of goods or promoting technical or economic progress, an otherwise anti-competitive agreement may be allowed if it is for "improving product quality", "enhancing efficiency", "increasing the efficiency and competitiveness of small and medium-sized undertakings", or "safeguarding legitimate interests in foreign trade".[48] The last one provides the basis for exempting export cartels. Moreover, any agreement whose purpose is "prescribed by law or State Council" is given blanket authority to proceed regardless of its effects on domestic or foreign competition.[49]

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[45] See Zhang [2014] for a discussion of China's decision-making process on competition cases.

[46] Specifically, Article 85:3 of the Treaty Establishing the European Community.

[47] See Gonzalez Diaz [1995] for a discussion of ancillary restraints in EU competition law.

[48] Article 15 of the AML.

[49] Whereas other grounds for exempting agreements from AML scope are qualified by the necessity of proving that "the agreements reached will not substantially restrict competition in the relevant market and that they can enable the consumers to share the benefits derived therefrom", a similar requirement is not imposed on export cartels or on agreements whose purpose is prescribed by law or State Council.

3.3. True conflict

Most states, including the US, are like China insofar as their national competition laws are not applied to their own export cartels unless domestic commerce is adversely affected by the restrictive export arrangements.[50] The rationale for this retrenchment was articulated plainly in one US case that noted competition laws exist for the protection of national, not foreign, interests.[51]

Yet, few states are like China insofar as governments would expressly defend the anti-competitive conduct of their producers in foreign lawsuits. The implicit exemption of export cartels from national competition law does not constitute an official endorsement, nor should it give rise to an expectation that the cartel would be conferred immunity under foreign law. [52] But in *United States v. The Watchmakers of Switzerland*, the Swiss government attested that the disputed conduct was taken "at the behest and with the encouragement of the Swiss Confederation" [Matsishita and Repeta 1982: 60]. The Japanese government likewise owned up to the conduct of its domestic producers, claiming that it "directed the establishment of an export cartel and that the Japanese television manufacturers and exporters had no alternative but to establish the agreement and regulation in compliance with the said direction".[53]

If not for the intervention of a foreign government, it is plain that the US antitrust law would have to be applied on a foreign cartel whose activities outside US territorial jurisdiction have "direct, substantial and reasonably foreseeable effect" on US commerce.[54] In the 1970s, the Supreme Court tempered this prosecutorial zeal and grounded it on comity and respect for foreign sovereignty, primarily in cognizance of the separation of powers of the judiciary and executive branch and the former's reluctance to intrude on the latter's conduct of foreign relations [Kadish 1982]. The factors that courts must consider and weigh before refraining from exercising jurisdiction were identified from various case laws and

[50] Suslow [2005] surveyed 55 national competition laws and found that except for a few, countries have changed their laws to remove explicit exemptions on export cartels.

[51] *United States v. Minnesota Mining & Mfg. Co*., 92 F. Supp. 947 [D. Mass. 1950], available at https://law.justia.com/cases/federal/district-courts/FSupp/92/947/1803422/.

[52] When American wood pulp producers were accused of cartel behavior by the European Economic Community in the early 1980s, the US government "virtually endorsed the Europeans' lawsuit" [Atwood 1987:160].

[53] Ibid, citing Z*enith Radio Corp. v. Matsushita Elec. Indus. Co*., 513 F. Supp. 1100 [E.D. Pa. 1981].

[54] In *United States v. Aluminium Co. America*, the Effects Doctrine is expressed as follows: "Any state may impose liabilities even upon persons not within its allegiance for conduct outside its borders that has consequences within its borders which the state reprehends." Section 6a of the 1982 Foreign Trade Antitrust Improvement (FTAIA) affirms this principle.

encapsulated in a multifactor balancing test.[55] Of the 10 factors included in the test, the *Vitamin C* case focused on the degree of conflict in laws. Mere differences in laws do not justify abstention; there ought to be "true conflict" to the extent that defendants could not have complied with the laws or policies in both countries.

As courts have to balance several countervailing factors, decisions are likely to be inconsistent and unpredictable.[56] This is true not only in the *Vitamin C* case, but also in previous cases involving jurisdictional conflicts with the Japanese government. Importantly, the current US-China dispute is reminiscent of US-Japan trade relations in the 1970s. The major sources of tension then were the Japanese distribution system, exclusionary business practices and *keiretsu* relationships that were blamed for foreclosing US access to the Japanese market, and the pricing strategy of Japanese firms that was perceived to have facilitated the incursion of their goods in the US market.[57]

In *re Japanese Electronic Products*, two US firms filed antitrust claims against seven Japanese television manufacturers[58] for predatory pricing. Concretely, the Japanese firms were accused of conspiracy to fix and maintain artificially high prices for products sold in Japan, while setting and maintaining artificially low prices for products exported to the US, for the purpose of driving out their American competitors.[59] The trial court did not find sufficient evidence to proceed with the case, but the court of appeals disagreed with the lower court's summary judgment. The Supreme Court, however, reversed the decision of the court of appeals and remanded the case without resolving it.[60]

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[55] The 10-factor test, as outlined in the FTAIA, includes: (1) degree of conflict with foreign law or policy; (2) nationality of the parties, locations or principal places of business of corporations; (3) relative importance of the alleged violation of conduct here as compared with conduct abroad; (4) extent to which enforcement by either state can be expected to achieve compliance, availability of a remedy abroad and pendency of litigation there; (5) existence of intent to harm or affect American commerce and its foreseeability; (6) possible effect upon foreign relations if the court exercises jurisdiction and grants relief; (7) if relief is granted, whether a party will be placed in the position of being forced to perform an act illegal in either country or be under conflicting requirements by both countries; (8) whether the court can make its order effective; (9) whether an order for relief would be acceptable in this country if made by the foreign nation under similar circumstances; and (10) whether a treaty with the affected nations has addressed the issue. In *re Vitamin C,* the appeals court concluded that the factors "clearly weigh in favor of U.S. courts abstaining from asserting jurisdiction."

[56] Atwood [1987] discerned that the application of comity has been so "ad hoc and case-by-case in nature that principles of clarity, fairness, and predictability are at risk."

[57] These issues were addressed in the 1989 Structural Impediments Initiative talks between the US and Japan [Cooper 2001].

[58] Later, other Japanese producers of consumer electronics were impleaded, bringing the number of defendants to 21. The case is also titled "Matsushita Electric Industrial Co. Ltd. et al. v. Zenith Radio Corp. et al".

[59] The complainants, National Union Electric and Zenith Radio, filed separate cases in 1970 and 1974, respectively, which were consolidated in *re Japanese Electronic Products Antitrust Litigation*, 388 F. Supp. 565, 567 [1975].

[60] Although the Supreme Court reversal left the case unresolved, the decision shows an inclination of the Court to accept an efficiency-based explanation for the observed behavior of the defendants. Specifically, the Court maintains that the alleged predatory motive for low prices is "speculative" and "the evidence did not rebut the more plausible inference that petitioners were cutting prices to compete in the American market and not to monopolize it." *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 [1986].

Although the courts focused on the substance of the complained-of conduct, i.e., predatory pricing, the case file reveals the industrial policy of Japan during the period, which is strikingly similar to China's current policy. In an *amicus curiae* brief to support the Japanese manufacturers' sovereign compulsion defence, the MITI affirmed that it directed the price agreements among the Japanese producers and regulations enforced by the Japan Machinery Exporters Associations on its members.

> In order that Japanese exports do not cause unnecessary disruptions in the national economies of Japan's trading partners, one of the basic trade policies is to assure that Japanese exporting is carried on in as orderly a manner as possible. MITI is the government organ empowered and responsible for the detailed implementation of the said basic trade policy. [Mastsushita and Repeta 1982: Appendix A]

Two major laws represented the Japanese trade policy during this period: the Export and Import Trading Law (also referred to as "Transaction Law") and the Foreign Exchange and Foreign Trade Control Law ("Control Law"). MITI was then administering price and quantity restrictions on exports purportedly to avoid dumping duties. Price control or "check price" took the form of minimum export price, while quantity control was an allocation among exporters based on their past export volumes. The Control Law authorized MITI to issue export licenses through which it was able to enforce price and quantity controls consistent with the country's balance of payments target. The Transactions Law allowed exporters to enter into (cartel) agreement on price, quantity, quality and other terms of exports to a particular destination [Matsushita and Repeta 1982].

The brief describes how MITI obliged the manufacturers to coordinate their prices in order to meet trade policy goals:

> …MITI will generally first direct the relevant Japanese industry or trade association to enter into Arrangements (which include both manufacturers' agreements and association regulations)…
>
> Where this procedure is deemed to be insufficient…MITI will exercise its powers…without prior direction to the industry or trade associations to enter into such Arrangements.
>
> [S]uch Arrangements…are the *actual implementation of MITI's trade policy* itself…and has in fact a *compulsory power* equivalent to law.
>
> Therefore, the Arrangements…are *not private agreements* in effect and are no less than the implementation of the foreign trade policy of MITI, despite their form as agreements made among private parties. (Italics supplied.) [ibid.]

Specific to the export of television sets to the US, MITI declared[61]:

> [I]n view of the importance of televisions as one of Japan's export products, the need for assuring their orderly exportation to avoid the possibility of trade conflicts…MITI directed Japanese television manufacturers including the present Japanese defendants to enter into an agreement…with respect to minimum prices and other matters concerning domestic transactions relating to exports to the United States, and further, directed the exporters to establish a new regulation to be observed by the members of the export association with respect to filing of export prices and other related matters
>
> …MITI supervised the preparation of such agreements and regulation…Had the Japanese television manufacturers and exporters failed to comply with MITI's direction to establish such an agreement or regulation, MITI would have invoked its powers…to unilaterally control television sales for export to the United States and carry out its established trade policy.

The Supreme Court did not have to evaluate the sovereign compulsion defence since it was offered to immunize the defendants from allegation of cartel behavior. Because the plaintiff's conspiracy theory was dismissed, the compulsion defence was rendered moot. Still, the Supreme Court expressed reservation on the validity of the sovereign compulsion defence when it declared: "[T]he court also believed it was *unclear* that the check prices in fact were mandated by the Japanese Government, notwithstanding a statement to that effect by MITI" (*italics supplied*).[62]

Yet, in 1981, MITI sought the view of the US Department of Justice whether its policies concerning exports of automobiles[63]—the same ones applied to television sets and electronic products in general—would not give rise to violations of US antitrust laws. The latter unambiguously confirmed the applicability of sovereign compulsion defence.

> In these circumstances, we believe that *the Japanese automobile companies' compliance with export limitations directed by MITI would properly be viewed as having been compelled by the Japanese government, acting within its sovereign powers.* The Department of Justice is of the view that implementation of such an export restraint by the Government of Japan, including the division among the companies by MITI of the maximum exportable number of units, and compliance with the program by Japanese automobile companies, would not give rise to violations of United States antitrust laws. We believe that American courts interpreting the antitrust laws in such a situation would likely so hold. [Matushita and Repeta 1982: Appendix C] (Italics supplied.)

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[61] Ibid.

[62] *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 [1986].

[63] The communication was triggered by the Japanese government's announcement of applying voluntary export restraints on automotive exports to US over a three-year period [Matsushita and Repeta 1982].

In 1999, the US and Japan forged a bilateral antitrust cooperation agreement that restrains each state from unilaterally applying its own competition laws to the conduct of firms of the other state that occurs outside each state's borders, without proper notification, consultation and coordination. Subsequently, the US signed a similar cooperation agreement with its other major trading partners.

4. Comity and the developmental state

State interference at the expense of market competition is certainly not peculiar to developing countries that are supporting their own firms so they could collectively compete in the global market. Indeed, the US started the practice of exempting export activities from antitrust enforcement through the Webb-Pomerene Act (WPA). Enacted in 1918, WPA allows competing firms to form associations for the purpose of coordinating their export activities or put bluntly, to form export cartels. The immunity from antitrust prosecution does not apply to conduct that has anti-competitive impact on the US market, however.[64] In the face of mounting trade deficits and to address the public view that US exporters were being disadvantaged by stringent enforcement of antitrust laws, US Congress enacted yet another law to strengthen WPA. The Export Trading Company Act of 1982 (ETC Act) provides for issuance of an advance certification that a specific export trade activity does not violate antitrust laws since the trade restraint would not affect the US domestic market.[65] Certifications have been issued for agreements to restrict price and quantity in the export market—similar to the agreement in dispute in the *Vitamin C* case.[66]

Significantly, the US refuses to repeal WPA and ETC Act even as other jurisdictions have abandoned explicit, in favor of implicit, exemption of export cartels, and despite the limited impact of these laws in boosting US exports.[67] There is certainly virtue in being transparent when granting exemption from enforcement of any law, but the true value of explicit exemption is that it reduces exporters' uncertainty of antitrust prosecution in their home country. Moreover, the US defended its export cartel exemption as follows:

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[64] The immunity does not extend to enforcement of foreign antitrust law.

[65] ETC certificates are issued based on the exporter's declaration that the activity will: "(1) result in neither a substantial lessening of competition or restraint of trade within the United States nor a substantial restraint of export trade of any competitor of the applicant; (2) not unreasonably enhance, stabilize, or depress prices within the United States of the goods, wares, merchandise or services of the class exported by the applicant; (3) not constitute unfair methods of competition against competitors engaged in the export of goods, wares, merchandise, or services of the class exported by the applicant, and (4) not include any act that may reasonably be expected to result in the sale for consumption or resale within the United States of the goods, wares, merchandise, or services exported by the applicant" [Waller 1992:244].

[66] Based on Waller's [1992] survey, the majority of certifications pertain to exclusive agreements between a domestic supplier and an export intermediary, which may be construed anti-competitive to the extent that the latter refuses to deal with any of the former's competitors.

[67] See for example, Dick [1992], Waller [1992], Suslow [2005], and Sokol [2008]. Waller, in particular, notes that the ETC program failed to meet Congress' expectation that the antitrust exemption would allow American trading companies to compete effectively against Japanese *sogoshosa*.

> [*T*]*hese arrangements typically were conceived as mechanisms for domestic entities that lacked the resources to engage in effective export activity acting individually*. As such, they often had *pro-competitive effects* in that they added another player to the relevant markets and might bring innovation or lower prices. Moreover, they were not secret and therefore did not bear the hallmarks of what was traditionally considered to be a hardcore cartel. ([WTO [2003: 125], as cited in Suslow [2005: 799]) (Italics supplied.)

The Chinese government could have advanced the same argument in defending its own industrial policy that led to the *Vitamin C* case. Any developing country could likewise rationalize its industrial policy of facilitating agreements among its exporters on the ground that they would not have sufficient market power to exploit foreign markets even if they collude. In fact, empirical evidence exists that some export cartels from developing countries behave competitively, contrary to casual evidence of price manipulation (Karp and Perloff [1989], [1993]).[68]

In the face of US antitrust ambivalence, what is the prospect that a developmental state could avoid rebuke from a US court when it fosters pricing agreements, market allocation and mergers to create industries capable of competing in international markets? Most likely dim, in view of the current Supreme Court decision reversing the appeals court's decision to uphold the sovereign-based defences propounded by Chinese exporters.

The US understandably has the right to assert its jurisdiction over conduct that harms its own consumers, even if a foreign government openly approves such conduct. While comity is a valid defence in antitrust cases, it is not a principle of international law; therefore, its application is voluntary. Consequently, the US could treat a sovereign compulsion defence as *sui generis*, specific to a trading partner or market context.

Yet, comity exists to prevent one state from overzealously applying its own laws (and norms) to conduct that takes place within the borders of another state. By heeding comity, a state does not authorize or encourage a foreign state or its private parties to violate domestic laws. Rather, the exercise of comity is an act of according respect and proper consideration to policy choices made by another state. Court abstention to adjudicate whenever valid sovereignty-based defence exists is not an abdication of jurisdictional authority. Rather, it makes room for diplomacy, which eventually may compel states to address regulatory differences at the multilateral level. Meanwhile, in the absence of multilateral rules on competition enforcement, if courts align their opinions in favor of comity, antitrust cases may have to be resolved using a trade framework within a WTO dispute settlement system. This is not the first-best solution, since it is inferior to a multilateral agreement on competition policy. But it is certainly preferable to a unilateral enforcement that will likely increase tension between the two economic behemoths whose relation is already strained by past neglect of diplomacy.

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[68] Using a linear-quadratic dynamic feedback oligopoly model, Karp and Perloff found evidence of competitive pricing behavior by major rice exporters from China, Pakistan and Thailand in the 1989 paper, and of coffee export cartels from Brazil and Colombia in the 1993 paper.

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